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IN THE

Supreme Court of the United States

October Term, 1964

No. 656

STANLEY S. HERSHEY and RUTH HERSHEY,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BERNARD B. LAVEN,
530 West Sixth Street,
Suite 1109,
Los Angeles 14, California,
Attorney for Petitioner.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

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COMMISSIONER OF INTERNAL REVENUE,

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Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

Petitioners by their counsel pray that a Writ of Certiorari issue to review the decision of the United States Court of Appeals for the Ninth Circuit, which affirmed the decision of the Tax Court of the United States and opinion of the United States Court of Appeals for the Ninth Circuit was filed and entered on August 5, 1964.

Opinions Below.

The opinion of the United States Tax Court in support of its judgment is appended hereto and marked "Appendix I".

The opinion of the U. S. Court of Appeals for the Ninth Circuit is appended hereto and marked "Appendix II", which opinion is unreported.

Jurisdictional Statement.

The jurisdiction of the Supreme Court of the United States is invoked pursuant to the terms and provisions under 28 U. S. C. Section 1254, subdivision 1.

Questions Presented.

Was the Petitioner deprived of the right guaranteed by the Fifth Amendment to the Constitution of the United States by means of the following proceedings by the Commissioner of the Internal Revenue which was affirmed by the Tax Court of the United States and the U. S. Court of Appeals for the Ninth Circuit?

1. By the Commissioner arbitrarily assessing the Petitioner with gross income instead of net income, contrary to the provisions of the 1939 Internal Revenue Code, Section 21(a) and (b), and the regulations promulgated thereunder which provide that the cost of goods are deductible in arriving at gross income.

2. By the Commissioner arbitrarily disregarding the net worth, bank deposits and percentage of profit methods of determining additional income, contrary to Section 41 of Internal Revenue Code of 1939.

3. By the Commissioner in making his assessment arbitrarily disallowed the cost of goods by rejecting the substantial uncontradicted evidence that the Petitioner paid for goods sold.

Whether the decision of an administrative agency may be made which has the effect of taking property contrary to the statutes and regulations which are clear and unequivocal.

Constitutional Provisions, Statutes and Regulations Involved.

Fifth Amendment to the Constitution:

"* * * nor be deprived of life, liberty or property without due process of law; * * *"

Section 21, Internal Revenue Code of 1939.

"(a) . . . 'Net income' means the gross income computed under Section 22, less the deductions allowed by Section 23."

Section 23, Internal Revenue Code of 1939.

"In computing net income there shall be allowed as deductions:

(a) Expenses.

(1) Trade or business expenses.

(A) In general.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, . . ."

Section 41 of the Internal Revenue Code of 1939.

"The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer, but if no such method of accounting has been so employed, or such method does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner clearly reflects the income. . . ."

Treasury Regulations 111, Section 29.23(a)-1.

"Business expenses—In general. Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business. . . . The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. . . ."

Treasury Regulations 111, Section 29.23(a)-5.

"Gross Income: In the case of a manufacturing, merchandising, or mining business 'gross income' means the total sales less cost of goods sold. . . ."

Regulation 111, Sec. 29; 54-1,

"Every person subject to the tax * * * shall for the purpose of enabling the Commissioner to determine the correct amount of income subject to the tax, keep such books of accounts or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits and other matters required to be shown in any return."

Statement of the Case.

This proceeding involves the Federal income tax liability of the Petitioner for the years 1950, 1951 and 1952.

Petitioner Stanley S. Hershey in the fall of 1950 commenced a business of collecting scrap metals and selling it mainly to one scrap dealer, Alpert & Alpert, and continued this business during the years of 1951 and 1952.

In August of 1950 Alpert & Alpert set up a separate account under the name of H. Jackson under which it is claimed that it paid the petitioner in cash for part of the scrap delivered to it, receipts of which monies were never signed for by the petitioner and were in the handwriting of an employee of Alpert & Alpert. The balance of petitioner's deliveries of scrap metals were recorded on the books of Alpert and Alpert under the name of S. S. Hershey and were paid by its check.

Petitioner filed income tax returns for the calendar years of 1950, 1951 and 1952, which included to the penny all monies received from Alpert & Alpert under the S. S. Hershey weight slips. An investigation was commenced by the Commissioner of Internal Revenue and a certified public accountant, employed by the petitioner, advised that if amended returns were filed, petitioner would be making a voluntary disclosure and avoid criminal prosecution. The certified public accountant filed amended returns for the years of 1950, 1951 and 1952, which included the gross receipts of all of the weight slips under the name of H. Jackson and S. S. Hershey, and deducted 5/7th on the average price of 7¢ per pound as cost of goods, based on 2¢ per pound which petitioner told him was his profit and supported by a letter dated September 15, 1952, signed by National Tapered Wings [Ex. 9].

The testimony of the respondent's own witness at the Tax Court hearing, Mr. Hooykass, was that his company (the main source of petitioner's scrap metals) received the entire amount which petitioner received, less 2¢ a pound [R. 211, 511, 505-506].

The permanent ledgers of Alpert & Alpert did not show that it paid any cash to petitioner, although it had a complete record of all checks paid [R. 288]. The Commissioner exerted great effort in preparing a net worth statement of the petitioner's assets, which was substantially less than the gross receipts on the amended returns filed; nevertheless he arbitrarily chose to disregard it [Ex. 48; R. 761-763, 809, 822, 922-928], and assessed the petitioner on the basis of gross receipts shown on the amended returns [Exs. 4D-6F].

The Commissioner through its revenue agent assumed without any written receipts signed by petitioner that he received the total amount represented by the H. Jackson weight slips [R. 866-869, 889-890, 896-897, 900, 903-908], even though it was the policy of the Commissioner to disallow cash expenditures where there were not any signed receipts [R. 862].

In addition there was presented before the Tax Court evidence of cost of goods purchased from California Duplicating Company in the amounts of $132.60 for 1951 and $2,608.80 for 1952 [R. 58, 59, 702-746], which were not deducted by the Commissioner or the Tax Court. (Opin. p. 25, Appx. I.)

There was no testimony whatsoever that anyone of Alpert & Alpert paid any cash whatsoever on the H. Jackson weight slips to the petitioner prior to February 20, 1951 [R. 370-372]. This amounted to $12,167.78 [R. 349-356]. A number of weight slips in November 1951 were in the handwriting of persons who did not testify making any payment to petitioner. It was assumed this money was paid to petitioner [Ex. 23; R. 328-335], nevertheless the Commissioner and Tax Court included this amount as gross receipts.

The Commissioner also included the gross receipts contained in the amended returns under the H. Jackson weight slips as additional income to the petitioner without deducting a loan of $25,000.00 to Aircraft Tapered Sheets on December 10, 1951, although the evidence was that Aircraft Tapered Sheets received this loan of $25,000.00 and no part of which was received by the petitioner [Ex. 27; R. 292]. This loan was repaid by credits of scrap materials which were obtained by petitioner from Aircraft Tapered Sheets and delivered to Alpert & Alpert on the weight slips under the name of H. Jackson and was completely repaid on April 28, 1952 [R. 318]. On or about May 22, 1952, petitioner negotiated another loan of $25,000.00 from Alpert & Alpert and at his request Alpert & Alpert's check in this amount was issued to Aircraft Tapered Sheets on May 22, 1952 [Ex. 38; R. 293]. This loan was repaid by credits similar to those made in repayment of the prior $25,000.00 loan and this loan was completely repaid by October 17, 1952 [R. 318].

Nevertheless, the Commissioner assessed the petitioner with additional income in the statutory notice without deducting any amount for cost of goods sold or allowing credits and offsets of the loan of the total amount of $50,000.00 to Aircraft Tapered Sheets.

It was clearly demonstrated that the Commissioner's assessment in statutory notice was not only incorrect but impossible [Exs. 49, 50, 51, 52.] The Commissioner's calculations show a gross profit of $91,484.99 for 1951 [R. 752-755, 767-768], which would amount to a receipt of approximately 10¢ per pound. In 1952 $115,694.99 for 1,099,790 lbs. it would be in excess of 10¢ per pound [R. 769]. The exhibits clearly reflect

that the average gross amount received by petitioner was approixmately 7¢ per pound [Exs. 49, 50, 51, 52].

The Commissioner assessed the deficiencies in question on the basis of gross receipts instead of gross income, without allowing for cost of goods, or any of the other deductions heretofore set forth and in addition assessed a 50% fraud penalty.

The petitioner promptly filed a petition with the Tax Court of the United States, requesting a re-determination of the asserted deficiencies. Following trial of the issues before the Tax Court of the United States, the Tax Court sustained the Commissioner, except for some minor adjustments for cost of goods sold, even though it concluded that "we believe the evidence reasonably supports that petitioner made payments to suppliers in cash and that the evidence was not equally clear that the entire amount shown on the H. Jackson weight slips constituted an additional income to petitioner (Opin p. 25, Appx. I).

The petitioner filed a petition for review before the United States Court of Appeals for the Ninth Circuit, which affirmed the Tax Court's decision with any reference to any citation of applicable Federal decisions.

Reasons for Granting the Petition.

The Decision of the Tax Court of the United States and the United States Court of Appeals for the Ninth Circuit failed to recognize many basic fundamental issues of law and denied your petitioners due process of law guaranteed to them by the Constitution of the United States.

Each and all of the questions sought to be reviewed were raised by assignment of error, and were deter-

mined adverse to the petitioners, and resulted in a violation of the Fifth Amendment to the Constitution of the United States in that it takes his property away from them, arbitrarily, in complete disregard of Section 21 (a) and (b), and upon the assumption of the Commissioner and an erroneous application of Section 41 of the 1939 Revenue Code and regulations thereunder.

The Courts below have construed the applicable statutes and regulations in a manner inconsistent with the settled judicial interpretation.

The great principles and great issues involved here are of such a nature that the impact of the Decision upon the taxpayers will be severe and harsh and give the Commissioner a license to arbitrarily assess taxpayers on the basis of gross receipts without deducting the cost of goods sold.

Both the Tax Court and the Ninth Circuit Court of Appeals completely ignore and refuse to follow the holdings of the settled decisions that gross income and not gross receipts is the foundation of income tax liability, and, manifestly, gross receipts cannot be called gross income, in so far as they consist of borrowings of capital returns of capital, or any other items, which Section 22 of the Internal Revenue Code 26 U. S. C. A., has excluded from gross income. *Clark v. U. S.*, 211 F. 2d 100, 102 (Cert. Den.); 348 U. S. 911. Congress intended the income tax laws to tax earnings and profits, less expenses and losses, carrying out a broad basic policy of taxing net, not gross income.

Tank Truck Rentals, Inc. v. C. I. R., 356 U. S. 30, 33.

The importance of the decision below is apparent from the novel view it takes of the authority of the Commissioner and from its practical impact on the administration of Justice.

The Commissioner used affidavits to determine the cost of goods and the schedules upon which he relied was not admitted into evidence [Ex. "L"; R. 235-241]. The evidence was not only uncontradicted but substantial that petitioner only received two cents per pound for scrap which he hauled, and, therefore, the Tax Court of the United States erroneously disallowed the cost of goods sold in the amended returns which was the sole basis of his assessment.

The presumption of regularity should attach to permanent books and records of Alpert & Alpert, which do not show any disbursements of cash to petitioner and there is no legal justification for the Commissioner to arbitrarily reject these permanent records. It was contrary to his own policy [R. 111; Sec. 29: 54-1].

The net worth computations prepared by the Commissioner do not substantiate the additional income claimed. According where his method is based on assumption and a disregard of the approved methods of proof of additional income such as net worth increase, bank deposits and percentage of profit and uncontradicted substantial evidence of cost of goods, then his assessment is in violation not only of the Congressional authority but Constitutional guaranty, and is not permissible under Section 41 of the 1939 Revenue Code.

It is axiomatic that the Commissioner has no alternative in face of unequivocal expression of Congress but to respect and apply the statutes as were intended by

Congress. Section 41 of the Internal Revenue Code of 1939 limits the authority of the Commissioner to compute income by such method as in his opinion clearly reflects income.

It was never intended that the Commissioner could guess at income. The word clearly means just what it says, plainly, honestly, straightforwardly and frankly. *Huntington Securities Corp. v. Busey,* 112 F. 2d 368, 370. Income should be reflected with as much accuracy as standard methods of accounting practices permit; *Peterson Produce Co. v. U. S.,* 205 Fed. Supp. 229, 244.

In the case of *Anson v. C. I. R.,* 328 F. 2d 703, 705, it was held that income tax is not imposed upon what income should be but upon what income actually is.

In *Polizzi v. Commissioner* (6th Cir.), 265 F. 2d 498, 501-502, it was held that a Commissioner's determination, based upon an assumption without proof that the taxpayer actually received the money, was insufficient to make an assessment of additional income.

Arbitrary action by an administrative agency is not due process, *Rudder v. U. S.,* 226 F. 2d 51, 53.

This Court in *Helvering v. Taylor,* 293 U. S. 507, at 515 declared

> "But whereas in this case the taxpayers' evidence shows Commissioner's determination to be arbitrary and excessive, it not be reasonably held that he is bound to pay a tax that he confessedly does not owe, unless his evidence was sufficient to establish the correct amount that may be lawfully charged against him."

The Ninth Circuit Court of Appeals disregarded its own decision which held the Commissioner's determination is invalid when it is arbitrary or capricious.

Cohen v. Commissioner, 266 F. 2d 5, 11 (1959) 9th Circuit.

These decisions and policies ought to still be the law and, if applied here, would require a different conclusion from that reached by the Tax Court of the United States.

Even the Tax Court admitted that it was not clear how much additional income the petitioner did receive, and its decision wholly fails to establish the reasonableness or accuracy of the income taxed or the method used to determine it.

It was the duty of the Tax Court to determine the correct amount of additional income and its sustaining of the 50% fraud on income which it has doubt becomes not only arbitrary but oppressive and should not be allowed to stand.

Helvering v. Taylor, 293 U. S. 507, 515;

Clark v. Commissioner, 266 F. 2d 698, 706, 715-717 (9th C. A.);

Harp v. Commissioner, 263 F. 2d 139, 141-142 (6th C. A.);

Gasper v. Commissioner, 225 F. 2d 284, 287-288 (6th C. A.).

The questions presented in this case are of importance in the administration of the Federal income tax law, and this precise issue of arbitrarily disallowing for cost of goods is present in many thousand pending tax

investigation cases. Review by this Court would furnish the rule for decision of the many proceedings involving this issue and prevent years of litigation.

Conclusion.

For the foregoing reasons, the Petition for Certiorari should be granted.

Respectfully submitted,

BERNARD B. LAVEN,

Attorney for Petitioner.

APPENDIX I.

Memorandum Findings of Fact and Opinion.

T. C. Memo. 1962-277

Tax Court of the United States

Stanley S. Hershey and Ruth Hershey, Petitioners, *v.* Commissioner of Internal Revenue, Respondent.

Docket No. 80635.

Filed November 23, 1962.

Bernard B. Laven, Esq., for the petitioners.

Alfred L. Margolis, Esq., and *J. Earl Gardner, Esq.*, for the respondent.

SCOTT, *Judge:* Respondent determined deficiencies in petitioners' income taxes and additions to the tax for the years 1950, 1951, and 1952 in the following amounts:

		Additions to Tax		
Year	Deficiency	Section 293(b) I.R.C., 1939	Section 294(d)(1)(A) I.R.C., 1939	Section 294(d)(2) I.R.C., 1939
1951	$ 1,029.58	$ 514.79	$97.21	$ 64.81
1951	42,601.24	21,300.62		2,569.88
1952	57,627.66	28,813.83		3,521.91
	$101,258.48	$50,629.24	$97.21	$6,156.60

Respondent concedes that he is in error in the assertion of the addition to the tax in the amount of $64.81 under section 294(d)(2) of the Internal Revenue Code of 1939 for the year 1950.

The issues for decision are:

(1 Whether petitioners for the years 1950, 1951, and 1952 filed false and fraudulent returns with intent to evade income tax.

(2) Whether petitioners had unreported net business income from the scrap metal business in the years 1950,

1951, and 1952 in the respective amounts of $6,221.42, $82,036.95, and $91,840.63 or any part thereof.

(3) Whether petitioners are liable for the addition to tax provided in section 294(d)(1)(A) of the Internal Revenue Code of 1939 for the year 1950 and the addition to tax provided in section 294(d)(2) of the Internal Revenue Code of 1939 for the years 1951 and 1952.

FINDINGS OF FACT.

The stipulation of facts which identifies some of the exhibits is incorporated herein by this reference.

Petitioners, Stanley S. Hershey and Ruth Hershey, husband and wife, filed joint Federal income tax returns for the years 1950, 1951, and 1952 with the district director of internal revenue at Los Angeles, California.

During part of 1950 and for some time prior thereto, Stanley S. Hershey (hereinafter referred to as petitioner) worked as a taxicab driver, employed by the Yellow Cab Company of California, and during a part of 1950 he also worked as an employee of the U-Paint Furniture Company.

In the fall of 1950 petitioner began a business of collecting scrap metals and selling it to large scrap dealers. During the years 1951 and 1952 petitioner continued his business of collecting and selling scrap metals.

Petitioners on their original 1950 income tax return reported total wages received from U-Paint Furniture Company and Yellow Cab Company of California in the amount of $1,331.49 and tips of 10 percent of wages from the Yellow Cab Company in the amount of $71.65. They reported as gross receipts from the scrap

iron and metals business the amount of $1,997.23 and net profits on that business of $1,115.23. This return was prepared for petitioners by a public accountant who also prepared petitioners' 1951 and 1952 original Federal income tax returns. This accountant's wife was a cousin of petitioner's wife. The amount labeled on petitioners' 1950 return as "Gross Receipts" was so labeled by the accountant who derived the amount by subtracting from what he computed as the amount received by petitioner in payment for scrap metals, the amount he computed as the cost to petitioner of those metals, and, therefore, this amount should more properly have been labeled "Gross Profits."

On their original Federal income tax return for the year 1951 petitioners reported gross receipts from sales of scrap iron and metals in the amount of $38,673.41, cost of sales of scrap iron and metals of $32,274, gross profit on sales of scrap iron and metals of $6,399.41, commissions earned due to sale of materials on exclusive sales arrangement of $3,048.60, total gross income of $9,448.01, operating expenses of $4,218.50, and net income from business of $5,229.51.

On their original Federal income tax return for the year 1952 petitioners reported gross receipts from sales of scrap iron and metals of $107,290.24, cost of sales of $92,621.95, gross profit of $14,668.29, commissions earned (cost of sales refund on exclusive materials sales arrangement) of $11,270.64, total gross income of $25,938.93, total operating expenses of $16,209.01, net operating income of $9,729.92, income from rubbish hauling of $1,950, total income from business of $11,679.92, gross salary from California Duplicating Company, Los Angeles, California, of $5,700 less com-

missions paid to Sophie Levin of $2,850, with a resulting net total wages from California Duplicating Company of $2,850 making a total net income of $14,529.92.

On each of the original Federal income tax returns for the years 1950, 1951, and 1952, petitioner showed his occupation as "Scrap Iron."

Petitioners did not show the accountant who prepared their original 1950, 1951, and 1952 income tax returns any regular books of account of their business operation. Petitioner provided this accountant with some weight slips and adding machine tapes, some cancelled checks and miscellaneous memoranda from which to prepare each of these returns. At the time of preparing the tax return for the year 1950 the accountant asked petitioner if he had books of account and petitioner replied that there were none, and in reply to the accountant's suggestion that petitioner should keep books and records of his business, which the accountant suggested that he would set up, petitioner said that he did not desire to have this done.

Sometime in the latter part of 1953, after an investigation by the Internal Revenue Service of petitioners' income tax returns for the years 1950, 1951, and 1952 had been commenced, petitioner and the accountant who had prepared the original returns for these years called upon the accountant's father who was a certified public accountant admitted to practice before the Treasury Department, requesting that he take over and prepare amended returns for petitioners. The certified public accountant discussed with petitioner what he considered to be the position of the Internal Revenue Service on voluntary disclosure. Petitioner

stated to the certified public accountant that there was undisclosed income in the original returns.

The certified public accountant inquired of petitioner whether he had books and records. Petitioner replied that he had none. The certified public accountant ascertained from petitioner that his sales were made to Alpert and Alpert Iron & Metal Company (hereinafter referred to as Alpert) and received permission from petitioner to visit the offices of Alpert and make lists of the sales or weight slips which he found there. The certified public accountant asked petitioner if he had done business under a name other than his own and petitioner replied that he had used the name of H. Jackson. The certified public accountant visited Alpert and made an analysis of weight slips. He then suggested to petitioner that since he had no books and records, cost of the goods sold might be obtained by going to petitioner's several sources of supply of the scrap metals and determining from their records the amount that petitioner had paid to them for such scrap metals. The certified public accountant requested permission from petitioner to go to his various suppliers, but petitioner told him not to go to these sources since if he did so, petitioner would probably lose the sources of supply, which he was in no position to do.

Petitioner told the certified public accountant that he received approximately 2 cents a pound profit from scrap metals and showed the accountant an agreement between him and National Tapered Wings, Inc., in the form of a letter to petitioner by that company, acknowledged and agreed to by petitioner. This letter dated December 19, 1952, states:

Reference is made to our letter of Agreement dated May 30, 1952 concerning maintenance and transportation services to be performed by your organization at our Plant No. 1, 3001 E. 11th Street, Los Angeles 23, California.

Since our Plant No. 2 is now in operation at 4906 Alcoa Avenue, Vernon, it is proposed that your organization extend the same maintenance and transportation services, as in the past, to the new Vernon facility, and under the same general terms and conditions as our prior letter of Agreement.

However, since it is now recognized that the volume of aluminum scrap generated (both plants combined), will constitute a recovery factor of definite value over and above accumulation, segregation, and transportation expenses, it is proposed that provisions be initiated to isolate aluminum scrap produced from that of other metals; and that such aluminum scrap be cleaned, weighed and sold for our account at the going-market rate of record for such aluminum scrap, and that we be reimbursed in the amount of such sales, less a handling allowance in the amount of 2 cents per lb. On this basis, we will require a sales receipt for each transaction, evidencing certified weight, etc., for our files, together with the covering remittances in each case.

It is further proposed that the afore-mentioned handling charge of 2 cents per lb. be considered applicable to the sale of aluminum scrap only and shall be considered as a fee over and above the

established maintenance charge of $12.50 per working day as negotiated under our prior agreement dated May 30, 1952.

Your acceptance of this proposed Amendment to our prior Agreement is respectfully requested. We are most sincerely appreciative of the excellent services which have been offered by your people in the past and trust that conditions will permit the continuance of such assistance throughout the coming year.

From this letter and petitioner's statement as to the profit received by him, the certified public accountant concluded that petitioner received a 2 cents a pound profit. He determined from the weight slips examined that petitioner's average sales price of scrap metals was 7 cents a pound. This accountant then decided that he would use a ratio, for determining cost of goods sold, to be used in the amended returns of five-sevenths of the sales price which he had computed.

The certified public accountant prepared amended Federal income tax returns of petitioner's income for the years 1950, 1951, and 1952. These returns were shown to petitioner, signed by petitioners, and filed with the district director of internal revenue at Los Angeles, California on January 12, 1954.

In the amended return for 1950 the salaries paid by Yellow Cab Company of California and U-Paint Furniture Company to petitioner were the same as reported in the original 1950 return, and the amount of tips received was the same. The amended return for 1950 showed, under income from scrap business, gross receipts from Alpert of $6,503.62. On a handwritten

schedule attached appeared the notation, "Alpert and Alpert (Frances Brody)" and two columns of figures, each under the title "S. Hershey", the first having figures after dates ranging from August 29, 1950, through November 29, 1950, totaling $4,120.62, and the second, figures opposite dates from December 5, 1950, through December 29, 1950, totaling $2,383, producing a total for the two columns of $6,503.62. This return showed cost of sales as five-sevenths of receipts which resulted in the amount of $4,645.44 leaving a gross profit of $1,858.18. This return showed total business expenses of $894 and net income of $2,367.32.

The amended return for 1951 showed gross receipts from scrap business in the amount of $111,276.83 listed as gross receipts from Alpert, S. Hershey $43,-708.69, and H. Jackson $67,568.14; cost of sales, five-sevenths of receipts, of $79,483.45; gross profit of $31,793.38; and net income of $27,574.88. This return also had attached handwritten sheets showing dates and amounts of payments, one schedule being headed "S. Hershey" and the other "H. Jackson," each schedule totaling the amount of receipts under the respective name shown on the amended return.

The amended return for 1952 showed gross receipts from Alpert in the amount of $172,561.78 divided under S. Hershey $117,151.95, and H. Jackson $55.409.83, cost of sales (five-sevenths of receipts) in the amount of $123,258.41, gross profit of $49,303.37, expenses of $16,209.01, net operating income of $33,094.36, income from rubbish hauling of $1,950, and income from salary from California Duplicating Company, Inc., the same as reported in the original return making a total income of $37,894.36. This amended return also had

attached handwritten schedules with dates and amounts under the name of "S. Hershey in a/c with Alpert & Alpert" and "H. Jackson in a/c with Alpert & Alpert."

On November 30, 1953, petitioner swore to the following statement:

> I Stanley S. Hershey solemnley [*sic*] swear that the statements set forth below are true and correct.
>
> 1. As of Dec. 31, 1952 to the best of my knowledge and belief had about 2 hundred dollars.
>
> 2. The cost and expenses of operating the S. S. Hershey Co., which is my solely owned junk business is to my belief correctly set forth upon my income tax returns as filed for the years 1950, 1951, 1952 and there are no additional expenses that I have failed to include thereon.
>
> 3. I have never transacted any business under any fictitious names or acted as agent for any one else in the collection of monies.

On October 29, 1957, petitioner was convicted, upon his plea of nolo contendere, in the United States District Court for the Southern District of California of the offense of making a false and fraudulent income tax return for himself and wife for the year 1951, and making a false and fraudulent affidavit relating to doing business under a fictitious name in violation of 26 USC 145(b) and 18 USC 1001, and sentence was imposed.

During the course of the investigation of his income tax returns for 1950, 1951, and 1952 petitioner stated to the examining agents of the Internal Revenue Service that he had never sold scrap metals to anyone other than Alpert.

Petitioner sold scrap metals to Golden West Salvage Company in the years 1950 and 1951 in the respective amounts of $1,218.02 and $484.86. During the years here in issue petitioner owned two trucks with which he picked up scrap metals from approximately nine places, and, except for relatively small amounts of such metals delivered in 1950 and 1951 to Golden West Salvage Company, delivered the metals to the yard of Alpert. Most of the metal which petitioner delivered to Alpert was aluminum scrap but he did deliver some other metals such as cast iron.

When one of petitioner's trucks arrived at the Alpert yard it was weighed on a large truck scale as it entered the yard and was again weighed on this scale when it left the yard and the difference in these weights was considered to be the weight of the scrap metals delivered in that truck. Commencing about the first of March 1951 the weighing of the trucks was done at times by Frances Brody (hereinafter referred to as Brody) who during the years here involved was office manager of Alpert, but generally this weighing was done by another employee of Alpert. A weight slip would be made out at the time the truck was weighed by Brody or the other employee of Alpert who weighed the trucks showing the date, the name S. Hershey, the kind of metal delivered, and the number of pounds of metal delivered.

Petitioner was usually in the office of Alpert during 1951 and 1952 at least once each day and sometimes more often and at times would look at these weight slips. However, the weight slips during the years 1951 and 1952 would be accumulated for a period of approximately 10 days without payment. When petitioner came

to Alpert's office during the period from March 1951 throughout 1952 for a settlement of the accumulated weight slips, he generally dealt with Brody. She would bring out all the slips on which payment had not been made, and petitioner and Brody would check together the original weight slips, and petitioner would decide which ones he wanted rewritten and the weight slips would be rewritten as petitioner instructed, generally by Brody. Some of the slips would be rewritten to place a portion of the poundage to be paid for on slips in the name of S. Hershey and the balance of such poundage would be placed on slips written in the name of H. Jackson. The name of a supplier designated by petitioner would be written on many of the new weight slips in the name of S. Hershey, but no supplier's name was written on the Jackson slips. It was not the custom in the scrap metal business to use a fictitious business name.

In some instances, particularly with respect to aluminum borings, where a weight slip was rewritten, a part of the poundages delivered would be listed on the S. Hershey slip at a price of from 1 to 1½ cents per pound under the price which petitioner was to receive from Alpert for the metal and a portion of the poundage would be listed on the slip under the name of H. Jackson, either at the full price to be received for the metal or the lesser price. Then a third slip under the name of H. Jackson would be written listing a poundage of metal of a type not actually delivered to Alpert by petitioner in a total amount equal to that listed on the other slips at a price less than the price to be received by petitioner at a price of 1 cent or 1½ cents per pound, or a slip showing "price adjustment" of this

amount per pound under either the name of S. Hershey or H. Jackson would be written to bring the actual price of the metal listed on the S. Hershey slip or the combined S. Hershey and H. Jackson slips to the actual price to be paid to petitioner. During 1951 and part of 1952 the price shown on the slips which listed the metals actually delivered would be the OPS allowed price without consideration of quantity bonuses allowed under OPS regulations. While there was some variation in the method of rewriting the slips, this was the general procedure followed in 1951 and 1952.

After the writing of the new weight slips was completed, the original slips would be destroyed promptly by petitioner, or by Brody. No original weight slips were left undestroyed. The new weight slips were written in duplicate, one copy given to Hershey, and the other kept by Brody for Alpert's records. Hershey, while still in Alpert's office, destroyed his copy of the new slips bearing the name, "H. Jackson," but left Alpert's office with the rewritten copy of the weight slips bearing the name, "S. Hershey."

Petitioner was paid by checks or credit to his loan accounts with Alpert for the amounts shown as due him on the Hershey weight slips and was paid by cash or credit to his loan accounts with the amounts shown on the Jackson weight slips. The total amounts received by petitioner from Alpert as reflected on the weight slips as rewritten under the names of S. Hershey and H. Jackson were as follows in the years 1951 and 1952:

	1951	1952
S. Hershey	$ 44,345.42	$119,764.84
H. Jackson	70,942.54	65,521.31
Total	$115,287.96	$185,286.15

The first weight slip in the records of Alpert in the name of H. Jackson is dated in January 1951. This slip was not written or paid by Brody. From August 20, 1950, until February 20, 1951, Brody was away from Alpert's office on a trip. She had no dealings with petitioner prior to February 20, 1951. Shortly after she returned to work on February 20, 1951, she was informed by one of the Alperts who was a partner in the business that weight slips were being rewritten for petitioner and that some of the rewritten slips were under the name, "S. Hershey" and others under the name, "H. Jackson." Brody is now, and has been for a number of years, a partner in Alpert, but during the years 1950 through 1952 she was not a partner but only an employee. She had been employed by Alpert from 1930. At the time she was first employed by Alpert she was a bookkeeper and has since that time done work involving at least in part the keeping of Alpert's books.

National Tapered Wings, Inc., was one of petitioner's sources of supply of scrap metals in 1951 and 1952. Under date of May 30, 1952, that company, by Frank E. Hooykaas, its vice president, wrote a letter to petitioner, acknowledged and agreed to by petitioner, which stated as follows:

> This letter will serve to confirm our recent discussion, at which time it was agreed that your organization will, for a fee of $12.50 per work-day (not to exceed a total of $325.00 per month) perform the following maintenance and transportation services as required, until further notice:
>
> Clean-up and maintenance of all yard and parking areas, including accumulation, removal and/

or disposal of all surplus wood, papers, tubing, scrap-metals, used oils or other fluids and other refuse; and including the occasional temporary use of your trucks, by appointment arrangements, for transporting within the Los Angeles area, either incoming raw materials or out-going finished machine parts to or from our local customers during periods of overload in our own shipping department.

It is further understood that your organization will provide the truck-driver as required and that necessary insurance covering both truck and driver will be carried by you.

Your acceptance of this Agreement by acknowledgement hereto is respectfully requested.

Prior to July 1, 1964, National Tapered Wings, Inc., kept no control over the amount of scrap which it generated and which was sold to petitioner but relied on the weight slips presented by petitioner as indicating the amount of scrap sold by it to petitioner. Hooykaas, vice president of National Tapered Wings, was associated with petitioner in a partnership which was dissolved in 1952 when its business was incorporated under the name, "California Duplicating Company." The father of Frank E. Hooykaas owned a capital interest in the partnership and stock in the corporation.

Sophie Levin, referred to on petitioner's income tax returns as receiving commissions from him in connection with the California Duplicating Company, was a sister of Frances Brody.

On May 1, 1952, petitioner, Bert Johnson, and Frank A. Hooykaas, the father of Frank E. Hooykaas, en-

tered into an agreement to dissolve the partnership of California Duplicating Company which then existed between them and to organize a corporation in which it was agreed that 37½ percent of the stock would be purchased by each Frank A. Hooykaas and Johnson and 25 percent by petitioner.

In April 1952 Brody advanced to petitioner $20,000. She obtained $10,000 of the amount advanced to petitioner from Alpert and entered the advance on Alpert's books as a loan to petitioner under date of April 28, 1952. A signature, "Sophie Levin" appears on a document which states:

> THIS AGREEMENT is entered into at Los Angeles, California, this .... day of April, 1952, by and between S. S. HERSHEY, hereinafter referred to as "Hershey", and SOPHIE LEVIN, hereinafter referred to as "Mrs. Levin."
>
> WHEREIN it is mutually agreed as follows:
>
> 1. Mrs. Levin hereby transfers to Hershey the sum of Twenty Thousand Dollars ($20,000.00) for the uses and purposes hereinafter set forth.
>
> 2. Hershey agrees to purchase in his own name from existing stockholders shares of stock of the California Duplicating Company, 3228 Union Pacific, Los Angeles, a California Corporation, with the Twenty Thousand Dollars ($20,000.00) herein received, which shares of stock Hershey warrants will represent a twenty-five per cent (25%) interest in the said corporation.
>
> 3. Hershey agrees to hold fifty per cent (50%) of the said shares of stock purchased with the aforesaid Twenty Thousand Dollars ($20,000.00) in trust for Mrs. Levin.

4. Hershey acknowledges and agrees that the sum of Ten Thousand Dollars ($10,000.00) of the money received from Mrs. Levin represents a loan from her to him, and Hershey agrees to repay to Mrs. Levin the said sum of Ten Thousand Dollars ($10,000.00), without interest, within six months from the date hereof.

5. In consideration of the execution of this agreement, Hershey agrees to turn over and transfer to Mrs. Levin, immediately upon his receipt thereof, fifty per cent (50%) of all income of every nature whatsoever which he receives from or through the stock purchased with the aforesaid Twenty Thousand Dollars ($20,000.00) whether said income be in the form of profits, dividends, emoluments, accumulations, distributions or any other form.

Hershey further agrees to give to Mrs. Levin, upon receipt, fifty per cent (50%) of any assets of the California Duplicating Corp. received by him, whether such assets represent a distribution of capital assets to stockholders on dissolution or otherwise.

6. It is understood that immediately upon Hershey's purchase of stock giving him a twenty-five per cent (25%) interest in the California Duplicating Company, he will commence to receive a weekly compensation for services rendered on behalf of said company. In further consideration of the execution of this agreement, Hershey agrees to give to Mrs. Levin one-half (½) of all salary and/or other compensation received by him from the California Duplicating Company.

IN WITNESS WHEREOF, the parties have caused this agreement to be executed the day and year first above written.

The $10,000 loan to petitioner was repaid to Alpert by credits to the loan account on Alpert's books from amounts shown as due to petitioner on either S. Hershey or H. Jackson weight slips.

About 80 percent of the business of California Duplicating Company during the years here involved, both as a partnership and as a corporation, was doing subcontracting work for National Tapered Wings, Inc. The scrap metals generated from the work performed by California Duplicating Company for National Tapered Wings, Inc., were considered to belong to National Tapered Wings, Inc. Sometime in 1951 petitioner paid approximately $7,000 to place a blower to assist in collecting scrap metals from National Tapered Wings, Inc., at the plant of that company with the understanding that in some manner he would be reimbursed for this expenditure.

Petitioner made payments to National Tapered Wings, Inc., for scrap metals throughout the year 1952 but the books of account of that company show no such payments listed as such after September 25, 1952. The payment to petitioner for the use of his trucks and rubbish hauling was made by some form of credit to the amounts which were due from petitioner to National Tapered Wings, Inc. Petitioner has continued from the years here involved until the date of trial to haul scrap metals for National Tapered Wings, Inc., but the arrangements for his compensation for this work were changed as of July 1, 1954.

On a ledger sheet in Alpert's records an account entitled, "Frank E. Hooykaas and S. Hershey (National Tapered Wings)" was set up on January 5, 1953, with a charge thereto of $25,000, which amount was shown to have credits against it discharging it in full by April 6, 1953.

Bardwell & McAilister was another source of supply of scrap metals used by petitioner in 1951 and 1952. The records of this company showed that petitioner paid to it $732.29 for scrap metals in 1951 and $339.02 for scrap metals in 1952. The records for 1952 did not show a payment of $80.89 by check on March 25, 1952. A check under that date from petitioner to Bardwell & McAllister was deposited in the bank account of that company.

Another of petitioner's sources of scrap metals in 1951 and 1952 was Aircraft Tapered Sheets. About December 10, 1951, petitioner negotiated a loan of $25,000 from Alpert and at his request Alpert's check for this amount was issued to Aircraft Tapered Sheets on December 10, 1951. This loan was repaid by credits thereto of amounts due to petitioner from Alpert for scrap metals listed on weight slips under the name of either S. Hershey or H. Jackson and was completely repaid by April 28, 1952. About May 22, 1952, petitioner negotiated another loan of $25,000 from Alpert and at his request Alpert's check in this amount was issued to Aircraft Tapered Sheets on May 22, 1952. Petitioner gave Alpert his personal note for this $25,000 loan. This loan was repaid by credits similar to those made in repayment of the prior $25,000 loan and this loan had been completely repaid by October 17, 1952.

In addition to the two $25,000 loans and the $10,000 loan in connection with the California Duplicating Company stock purchase, Alpert made other loans to petitioner which were repaid by credits of amounts shown as due petitioner on weight slips in the name of either S. Hershey or H. Jackson. The first of such loans by Alpert to petitioner was on April 17, 1951.

There were produced at the trial by petitioner in response to respondent's subpoena two bound books, one marked "1951" and the other "1952" with entries therein on the bound pages mostly in ink, but sometimes in pencil. These books contained figures listed as receipts and under the names of the various suppliers of scrap metals to petitioner showed weights, gross dollar amounts, and net dollar amounts with notations of "paid by check" followed by an amount, "paid by cash check" followed by an amount, and "paid by cash" followed by an amount. The gross dollar amounts of receipts shown in these books coincided substantially with the payments by Alpert by check to petitioner. Some checks drawn by petitioner payable to cash and cashed by officers of companies from which petitioner purchased scrap metals reconciled with entries in these books.

Prior to the week before the trial of this case these books had not been shown to any agents of the Internal Revenue Service or to the representatives of respondent. These books had not been shown to petitioner's accountants who prepared the original returns or the amended returns for the years here involved. These books show as cost of goods sold in 1951 and 1952 the following:

Name of Vendor	By Check	By Cash Check	By Cash	Total
1951				
Pasadena Air Products	$ 1,109.15	$	$ 809.33	$ 1,918.48
National Tapered Wings	2,807.00	215.20	4,272.04	7,294.24
Aircraft Tapered Sheets	14,262.64			14,262.64
Taken by Alpert against loan	4,344.45			4,344.45
Com-Air Products, Inc.	1,128.64		1,680.90	2,809.54
Bardwell-McAllister	732.29			732.29
Paramount Engineering, Inc.	513.06			513.06
California Duplicating Co., Inc.			132.60	132.60
Aero-Machine	247.57			247.57
Aeromatic	66.25			66.25
Dix Manufacturing Company	—0—			—0—
Coast Spar Milling, Inc.	—0—			—0—
Totals	$25,211.05	$ 215.20	$ 6,894.87	$32,321.12
1952				
Pasadena Air Products	$	$3,670.35	$ 2,268.70	$ 5,938.95
National Tapered Wings	8,559.00		19,833.00	28,392.00
Aircraft Tapered Sheets	44,574.29			44,574.29
Com-Air Products, Inc.	3,533.25		609.25	4,142.50
Bardwell-McAllister	419.93			419.93
Paramount Engineering, Inc.	202.20	151.20	376.42	729.82
California Duplicating Co., Inc.			2,608.80	2,608.80
Aero-Machine	353.07			353.07
Mercury Engineering			1,397.03	1,397.03
Forge-Screw	170.76			170.76
Air-Ways			3,302.40	3,302.40
Dix Manufacturing Company				—0—
Coast Spar Milling				—0—
Totals	$57,812.50	$3,821.55	$30,395.50	$92,029.55

By rewriting weight slips to show metals received that actually had not been delivered, Alpert's inventory was somewhat distorted and was not accurately kept as required by OPS. Alpert, during the time OPS regulations were in effect during 1951 and 1952, charged over OPS ceiling prices for metals sold to one of its customers. Brody knew that the showing on weight slips of metals not delivered caused a distortion in Alpert's inventory and of the prices over OPS ceiling charged to one customer.

The cost of goods sold as shown in the statutory notice of deficiency was determined by respondent's agents from examining records of petitioner's suppliers. Petitioner told the examining agents of seven sources of scrap supply and the agents found nine. The cost of goods sold as computed by respondent's agents and used in the statutory notice of deficiency was $800.20 for 1950, $24,287.86 for 1951, and $71,401.58 for 1952. Petitioner's gross receipts from salvage sales to Alpert as used in the notice of deficiency were $7,800.83 for 1950, $115,287.96 for 1951, and $185,286.15 for 1952.

Respondent, in his notice of deficiency, determined that petitioners had unreported business income in the years 1950, 1951, and 1952 in the amounts of $6,221.42, $82,036.95, and $91,840.63 which was arrived at by adding to the receipts from sales to Alpert in 1950 and 1951, the receipts by petitioner from sales to Golden West Salvage Company and adding to receipts from the Alpert sales in 1952 the amount of $3,894.99 he desginated as other sales and in each year subtracting from the total sales, the total cost of goods sold as computed by respondent, the operating expenses as shown on petitioner's original returns, and the income from the scrap metal business as shown on petitioner's original returns. Respondent determined an addition to the tax under section 293(b) of the Internal Revenue Code of 1939 for each of the years here involved, an addition to the tax under both sections 294(d)(1)(A) and 294(d)(2) of the Internal Revenue Code of 1939 for the year 1950, and additions to the tax for the years 1951 and 1952 under section 294(d)(2) of the Internal Revenue Code of 1939.

ULTIMATE FACTS.

Respondent has not established by clear and convincing evidence that petitioners' income tax return for the year 1950 was false and fraudulent. Petitioner has failed to show error in the deficiency for 1950 as determined by respondent, and respondent has failed to show that any part of such deficiency is due to fraud with intent to evade tax.

Petitioners filed false and fraudulent income tax returns for the years 1951 and 1952 with intent to evade tax.

There is a deficiency in income tax for each of the years 1951 and 1952 due from petitioners, part of which is due to fraud with intent to evade tax.

OPINION.

The first issue that will be considered in this case is whether petitioners' income tax returns for the years 1950, 1951, and 1952 were false and fraudulent with intent to evade tax.

It appears from the record that on March 24, 1959, when the deficiency notice in this case was issued, the time within which the respondent might make an assessment of tax for the year 1950 had not expired because of consents executed by petitioners and respondent extending the period within which such assessment might be made until June 30, 1959, and petitioner does not contend to the contrary.

From the evidence, it appears that for the years 1951 and 1952, the period within which the respondent might make an assessment had expired on March 24, 1959, when the notice of deficiency was issued unless the period of limitation provided in section 275(a) of the

Internal Revenue Code of 1939 was inapplicable under the provisions of section 276(a) of the Internal Revenue Code of 1939 which provides that in the case of a false and fraudulent return with intent to evade tax, the tax may be assessed at any time. Petitioners alleged in their petition that the deficiencies for 1951 and 1952 were barred by the statute of limitations. The only defense to this allegation in respondent's answer is that petitioners' returns for these years were false and fraudulent with intent to evade tax.

The only evidence in this case with respect to the year 1950 tending to show affirmatively any omission of income from petitioners' original income tax return is with respect to the amount of $1,218.02 shown to have been received by petitioners from the Golden West Salvage Company in that year. Since only gross profits were shown in petitioners' original return for 1950, it is not clear that this amount was not included in the income reported on their income tax return. The evidence affirmatively shows that no payments under the name, "H. Jackson," appear from the records of Alpert produced at the trial as having been made in 1950. The first sales slip produced under this name was one dated in January 1951, and the only witness who testified with respect to payments to petitioner on slips made in the name of H. Jackson did not herself make any such payments until March 8, 1951. In fact, the evidence shows that this witness was away from Alpert's from August 20, 1950, until February 20, 1951. The evidence creates some suspicion that there was a knowing and intentional omission of income from petitioners' 1950 income tax return, but suspicions cannot substitute for the clear and convincing

evidence required to prove that a taxpayer filed a false and fraudulent return with intent to evade tax. We have, therefore, found as an ultimate fact and so hold that petitioners did not file a false and fraudulent income tax return for 1950.

The evidence with respect to the years 1951 and 1952 is clear and convincing that petitioner failed to report substantial amounts of income received. The testimony of the witness, Brody, supported by records of Alpert produced at the trial, was clear that payments in substantial amounts were made to petitioner on weight slips made out in the name of H. Jackson. The evidence that the winess, Brody, rewrote original weight slips to place some under the name of S. Hershey and others under the name of H. Jackson and destroyed some original weight slips discredits her testimony that the sole reason for making some slips under the name of H. Jackson was to accommodate petitioner. The evidence also shows other transactions between petitioner and Brody which tend to discredit her testimony that she received no personal benefit and Alpert received no benefit from rewriting of any of these weight slips. However, after considering this evidence, we are convinced that her testimony with respect to the payments of large amounts of cash to petitioner on weight slips listed in the name of H. Jackson is true.

This testimony of Brody is supported by other clear and convincing evidence in the record. It is supported by the amended returns for 1951 and 1952, signed and filed by the petitioners on January 12, 1954, in which petitioner listed receipts in the amounts of $67,568.14 and $55,409.83, respectively, under the name of H. Jackson. It is supported by the testimony of the certified

public accountant who made out petitioners' amended returns for 1951 and 1952 that petitioner stated to him that he had income in those years which was not reported and that in those years he was doing business under the name of H. Jackson. The evidence is equally clear that the gross receipts from the sale of scrap metals as shown on petitioners' original returns did not include any amounts petitioner received in cash on weight slips made out in the name of H. Jackson. While the evidence is not equally as clear that the entire amounts shown on the H. Jackson slips constituted additional income to petitioner, the evidence is completely clear and convincing that a very substantial portion of these amounts did constitute additional income to petitioner.

We are also convinced from the evidence that omission of such sizeable amounts from income could not have been an oversight on the part of petitioner but was with a willful intent to evade income tax on such receipts. Cf. *M. Rea Gano,* 19 B.T.A. 518 (1930).

Respondent places considerable stress on the fact that petitioner did not testify at the trial in an effort to refute the testimony of the witness called by respondent to establish that petitioners' returns were false and fraudulent and that there was some deficiency in tax for the years 1951 and 1952 which was in part due to fraud with intent to evade tax. We have not considered the failure of petitioner to testify in arriving at our conclusion that petitioners' returns for the years 1951 and 1952 were false and fraudulent with intent to evade tax and that there are deficiencies in these years due in part to fraud with intent to evade tax, since the evidence in the record is clear and convinc-

ing. We have considered petitioner's conviction on a plea of nolo contendere in 1951 only as a part of the general background of the case. Cf. *Lillian Kilpatrick*, 22 T.C. 446 (1954), affd. 227 F. 2d 240 (C.A. 5, 1955). We have found as an ultimate fact, and so hold, that petitioners' income tax returns for the years 1951 and 1952 were false and fraudulent with intent to evade tax and that there are deficiencies in those years due in part to fraud with intent to evade tax.

For the year 1950 the burden is upon petitioners to establish error in respondent's determination of the deficiencies asserted in the notice of deficiency. Petitioners argue with respect to the year 1950 that respondent's determination was arbitrary and for this reason it is not incumbent upon them to show the correct amount of deficiency but that this burden rests upon respondent.

We have set forth in some detail the method used by respondent to compute the deficiency for 1950 and the lack of cooperation he received from petitioner in this undertaking. We think that respondent's method of computing the deficiency for 1950 was reasonable in view of these circumstances and since there is no evidence in the record showing error in respondent's determination for 1950, we sustain the deficiency as determined by him for that year. Respondent has failed, however, to show that any part of this deficiency for 1950 was due to fraud with intent to evade tax.

Petitioners argue that respondent not only has the burden for 1951 and 1952 to show that their returns for those years were false and fraudulent and that there was some deficiency a part of which was due

to fraud with intent to evade tax, but also contend that respondent has the burden to show the amount of the tax since his determination was arbitrary. Once respondent has established that petitioners' returns were false and fraudulent and that there were deficiencies a part of which was due to fraud with intent to evade tax, it is incumbent upon petitioners to show error in respondent's determination of deficiencies. *Estate of W. Y. Brame,* 25 T.C. 824, 831 (1956), affirmed per curiam 256 F. 2d 343 (C.A. 5, 1958). Cf. *Avery v. Commissioner,* 22 F. 2d 6 (C.A. 5, 1957), affirming 5 B.T.A. 872 (1926). If a taxpayer shows that the Commissioner's determination is arbitrary and invalid, then he is not required to show the correct amount of tax due. *Helvering v. Taylor,* 293 U.S. 507 (1935). However, where there is no showing that the Commissioner's determination is arbitrary, since a taxpayer has the burden of proof, only such adjustments in the Commissioner's determination as he shows to be in error are properly made. Petitioners in the instant case argue that they have shown that respondent's determination was arbitrary and invalid. We do not agree.

The evidence shows that an internal revenue agent and a special agent obtained from records of Alpert and Golden West Salvage Company information as to payments made to petitioner and that they obtained from records of petitioner's suppliers amounts paid by petitioner for the scrap metals he sold. The evidence shows that petitioner was not cooperative in assisting the agents in their investigation in that he did not furnish the agents with the names of all the persons from whom he obtained scrap and did not inform the agents of any sales to Golden West Salvage Company.

The agents obtained their information as to suppliers other than those names given to them by petitioner from notations on records at Alpert. The evidence shows that petitioner informed the agents that he had no books of account. If in fact the books petitioner produced at the trial were books kept in the ordinary course of business by petitioner, which is not shown by the evidence to be a fact, their existence was not disclosed to respondent until shortly before the trial. Under these circumstances respondent cannot be said to have been arbitrary in failing to use these books in making his determination.

The manner in which respondent obtained the information as to receipts and cost of goods was a completely reasonable approach to a computation of income with the limited information furnished to respondent by petitioner. We, therefore, hold that respondent's computation is not arbitrary and the burden is upon petitioner to show to what extent his income is less than that as determined by respondent.

Petitioner relies to a large extent in his argument that respondent's determination is arbitrary on the net worth statement which was prepared by one of respondent's agents during the course of his examination of petitioner's returns which shows by a determination of increase in net worth during each of the years 1950, 1951, and 1952, plus estimated living expenses, that petitioner's estimated income as so computed was only $2,938.68, $4,862.10, and $2,080.04 for the years 1950, 1951, and 1952, respectively, in excess of the income as reported by petitioners on their original income tax returns for those years. On this statement is written:

> The figures set forth above are true and correct to the best of my knowledge.
>
> S. S. Hershey
>
> Subscribed & sworn before me this 30th day of of November 1953.
>
> Martin D. Lipman.

There is also a notation on this net worth statement as follows:

> In 1951 Mr. Hershey purchased an interest in The California Duplicating Co., Inc., for $10,000.00. The money used in this transaction was borrowed as explainted in the accompanying report. Since the inclusion of this would result in a contra entry it was not done.

The evidence in the record made at the trial shows that in fact petitioner borrowed the money for investment in California Duplicating Company in 1952 and that by the end of 1952 substantial repayment of this loan had been made.

There was also testimony by Brody that at one point in 1952 petitioner asked her to keep for him, and she did for a few days keep for him, $95,000 cash. The net worth statement does not contain any asset of cash. While, as petitioners contend, there have been numerous instances in which respondent's computation of a taxpayer's income on the basis of increase in net worth plus estimated living expenses, has been sustained as reasonable, respondent may use other methods of computing a taxpayer's income where such sources are available to him. Cf. *George M. Still, Inc.*, 19 T. C. 1072 (1953), affirmed *per curiam* 218 F. 2d 639 (C.A. 2, 1955).

For the years 1951 and 1952, petitioner contends both that he did not receive the full amount of receipts which respondent has included in his income and that his costs of scrap metals were greater than respondent has shown. Petitioners contend that the amounts represented by the price adjustments of 1 or 1½ cents a pound on aluminum borings were reported by them in 1951 as commissions earned due to sale of material on exclusive sales arrangement in the amount of $3,048.60 and for the year 1952 as commissions earned (cost of sales refund on exclusive material sales arrangement) in the amount of $11,270.64. Under respondent's method of determining business income as adjusted and subtracting thereform business income as reported on the original return he has not duplicated an inclusion of these amounts even if they were a part of petitioner's gross receipts from Alpert since these amounts were reported on petitioners' income tax return as part of business income. The evidence shows that in the year 1952 petitioner made a payment of cash to Brody of $3,000 consisting of one payment of $2,500 and one payment of $500 which was listed by her as part of "our share" from California Duplicating Company. This cash payment appears to be in addition to regular payments made by petitioner of one-half of the salary which he drew from California Duplicating Company. The record is not completely clear as to the nature of this item. However, the books produced at the trial show cost of purchases from California Duplicating Company in the amounts of $132.60 for 1951 and $2,608.80 for 1952 made by cash which were not included in respondent's computation of cost of sales.

Petitioner's next argument is in connection with the crediting of amounts shown on the H. Jackson slips against loan accounts on Alpert's books shown as made to petitioner. The evidence does show that these loans were repaid by petitioner to some extent with credits from slips made in the name of H. Jackson. However, the evidence is reasonably clear that the money advanced on loans to petitioner in 1951 and 1952 other than the two $25,000 loans where the checks were made to Aircraft Tapered Sheets, was for his own use, and, therefore, the crediting of amounts from the H. Jackson slips for the repayment of these loans was in effect a payment of this amount to petitioner. It, therefore, does not appear that there is any error in respondent's determination for failure to give recognition to these credits.

Petitioner contends that costs of sales are grossly understated in respondent's computation and that the computation of such costs on the basis of five-sevenths of sales price is a fair and reasonable basis aid should be accepted in lieu of respondent's specific computation. Petitioner argues that respondent's computation does not completely include all amounts which petitioner paid to obtain metals for which he received payment under the name of S. Hershey and that it does not include any amount paid for metals listed on slips under the name of H. Jackson. Petitioner relies upon the books that were produced at the trial to show an understatement for items shown on the weight slips under the name, "S. Hershey" of approximately $8,000 in 1951 and $20,000 in 1952. These books can be checked with respondent's computation with reasonable accuracy except as to amounts listed thereon as payments

in cash and part of the amounts shown as payments by credit to the loans made by petitioner with the checks issued to Aircraft Tapered Sheets and to some extent, the difference between respondent's computation of cost and that on the books produced by petitioner at the trial with respect to payments on this loan is a difference in years of application of such payments. We believe the evidence reasonably supports that petitioner made payments in cash that were not included by respondent in his computation of cost of goods sold of approximately the amounts shown in the books produced at the trial. On the basis of the evidence as a whole we find that petitioner's cost of sales is as shown in these books which is $32,321.12 for 1951 and $92,-029.55 for 1952. The evidence fails to show any further omitted costs in respondent's determination. In fact the evidence indicates that petitioner, prior to December 1952, was obtaining some scrap metals from National Tapered Wings, Inc., for which he made no payment except the service of hauling. There is no evidence of any payment made for scrap metals listed on H. Jackson slips except for such credits as may have been applied on the Aircraft Tapered Sheets advance for which full credit is given by accepting the amounts shown on the books produced at the trial.

Except for the adjustments set out above, we sustain the deficiencies as determined by respondent and also sustain the additions to the tax under section 293 (b) of the Internal Revenue Code of 1939 for the years 1951 and 1952 since a part of the deficiency for each of these years was due to fraud with intent to evade tax, and we sustain the addition to tax for 1950 determined by respondent under section 294(d)(1)(A)

of the Internal Revenue Code of 1939 for failure of proof by petitioners that such addition is not due. The additions to tax under section 294(d)(2) of the Internal Revenue Code of 1939 for the years 1951 and 1952, recomputed on the income for these years as determined herein, are also sustained for failure of proof on the part of petitioners that such additions to the tax are not due.

Decision will be entered under Rule 50.

APPENDIX II.

On Petition for Review of the Decision of the Tax Court of the United States.

United Sates Court of Appeals, for the Ninth Circuit.

Stanley S. Hershey and Ruth Hershey, Petitioners, vs. Commissioner of Internal Revenue, Respondent. No. 18,842.

[Aug. 5, 1964]

Before: Barnes, Hamley, and Browning, Circuit Judges.

Browning, Circuit Judge:

We have examined the record before the Tax Court, and conclude that the court's findings are adequately supported by the evidence. Our reasons, in summary form, are as follows:

I. *Determination of Deficiency*

A. *Income*

1. The Tax Court's determination that the amounts due on the H. Jackson weight slips reflected income to petitioner was directly supported by the unequivocal and uncontradicted testimony of the witness Brody that these amounts were in fact paid to petitioner in cash, and also by the amended returns reporting sums attributable to this source as income to petitioner. Significant secondary support was afforded by the testimony of Groger and Lipman that petitioner stated he had done business under the name of H. Jackson during the years in question, and by the testimony of Groger that petitioner admitted receiving income not reported in his original return.

Petitioner's attack upon the Tax Court's conclusion falls far short of demonstrating that it is clearly erroneous:

(1) The credibility of Brody was for the Tax Court to determine, and its conclusion that she was telling the truth cannot be rejected as mistaken.

(2) Petitioner's contention that his amended returns falsely exaggerated his income are rightly suspect, particularly when advanced in a proceeding to determine civil liability after criminal liability has been disposed of.

(3) As the Tax Court pointed out, the failure of the government's net worth calculation to establish receipt of unreported income may be explained by the fact that a $10,000 loan was mistakenly excluded from the computation although it was largely repaid by petitioner during the years in question, and also by Brody's testimony that during this period petitioner had substantial sums of cash not included in the government's calculation.

(4) Petitioner's argument that the total poundage reflected in Exhibit 50 is too small to support the Commissioner's calculation of income is refuted by Brody's testimony that although the total amount of money paid petitioner for a particular delivery of scrap was accurately stated on the weight slips relating to that delivery, the poundage of scrap delivered was not.

(5) Deficiencies in the Alpert records, such as failure to identify the recipients of particular cash disbursements, does not tend to prove that petitioner was not such a recipient.

(6) It is true, as petitioner points out, that Brody testified she did not write fictitious weight slips prior to February 20, 1951, and did not write certain of the November 1952 slips, but she also testified that in writing slips after February 20, 1951, she simply continued

a pre-existing practice, and that other employees participated in this practice both before and after the indicated date.

(7) Petitioner's statement to Lipman that the money petitioner received under the name of H. Jackson was not petitioner's conflicted with his earlier statement that he had never acted as an agent in the collection of money.

(8) Lipman's testimony that he did not attempt to reconcile the amount of cash paid under the H. Jackson account with the Alpert cash disbursement journals, and that he could not be certain that the amounts reflected in the H. Jackson weight slips were received by petitioner (rather than by Brody or some other person in the Alpert organization) seem to us to be of little significance.

2. There is some support for petitioner's contention that weight slips credited to the repayment of two $25,000 loans made by Alpert should not have been included in petitioner's income because the loans were made directly to (and repaid by) Aircraft Tapered Sheets, Alpert checks reflecting the loans were made out to Aircraft Tapered Sheets, the loans appeared in Alpert's ledger as charges to Aircraft Tapered Sheets' account, and an arguable inference might be drawn that scrap credited to the payment of these loans was collected directly from Aircraft Tapered Sheets by Alpert trucks. Nonetheless, we think the Tax Court's finding was justified. Petitioner gave his personal note for one of the two loans. Brody testified that both loans were actually made to petitioner, that petitioner was looked to for repayment, and that he did in fact repay the loans by directing that amounts due him for deliveries of

scrap be applied to their payment. Petitioner's amended returns reported as income to him amounts applied on these loans by Alpert. To the extent that it was shown that as between petitioner and Aircraft Tapered Sheets these loans represented payment for scrap, petitioner was allowed appropriate additions to his cost of goods sold. See I.B.3., below.

3. Since petitioner's gross receipts from Alpert were determined by totaling the amounts due on weight slips drawn in the names of S. Hershey and H. Jackson, payments made by petitioner on Alpert's $10,000 loan to petitioner would be included in his income only to the extent that those payments consisted of amounts due him under these weight slips.

4. The so-called "commissions" were not duplicated in determining the amount of petitioner's deficiency. They were included in the total income which petitioner reported in his amended returns. In arriving at the amount of the deficiency, the Commissioner subtracted the total income reported in the amended returns (including the "commissions") from petitioner's total income as calculated by the Commissioner.

B. *Cost of Goods Sold and Other Business Expenses*

1. The Commissioner was not required to compute the cost of goods sold on the basis of petitioner's estimates of his average cost-profit ratio, as opposed to ascertaining actual costs from the records of petitioner's suppliers. The Commissioner could properly conclude that petitioner's statement of income in his amended returns was essentially accurate, without being bound by petitioner's inaccurate calculation of his costs in the same return.

2. Hooykaas' testimony that petitioner's margin on purchases from his company was two cents per pound was based upon the witness's erroneous supposition that the weights and prices which petitioner reported to his suppliers were accurate. The evidence justified the conclusion that petitioner showed his suppliers only the S. Hershey weight slips, having destroyed the weight slips issued in the name of H. Jackson, and that the weights and prices shown on S. Hershey's slips were lower than the actual weights delivered and prices received by petitioner. Thus, on weights not reported to suppliers, petitioner paid suppliers nothing; on reported weights his actual margin exceeded the two cents margin which suppliers assumed they were paying. This conclusion is supported by suppliers' testimony that their income from scrap increased markedly when they ceased selling to petitioner.

3. To the extent that records produced by petitioner warranted an increase in the Commissioner's computation of cost of goods sold, the Tax Court made an appropriate adjustment. For example, the Tax Court added to the cost of goods sold those credits which petitioner's records showed he had received from Aircraft Tapered Sheets in payment of the loan to the latter of the $50,000 which petitioner had borrowed from Alpert. See I.A.2., above.

4. As we read the record, the Tax Court recognized the cost of items paid to California Duplicating Company as deductible. There was no adequate proof of additional unallowed costs.

5. The only evidence bearing upon whether the $7,000 advanced for the blower installed at the plant of National Tapered Wings was an expense of petitioner's

business was the meager and inconclusive testimony of the witness Hooykaas. Nevertheless, the burden of proof rested upon petitioner, and the Tax Court did not err in concluding that the burden was not met.

II. *Fraudulent Intent*

The finding that petitioner's returns for 1951 and 1952 were false and fraudulent with intent to evade tax was clearly and convincingly supported by the following evidence: Petitioner's participation in the preparation of weight slips containing false data and in the name of a fictitious person, and in the destruction of the original weight slips; petitioner's false statements that he had not transacted business under a fictitious name; the receipt of large sums of cash not reported as income; admissions to the witness Groger and in amended returns that petitioner had failed to report substantial amounts of income in two successive years; petitioner's failure to inform revenue agents of his sales to Golden West Salvage Company, and to identify all of his suppliers; and petitioner's false statement that he kept no books of account.

Affirmed.

The court has unanimously concluded that since the foregoing opinion relates solely to factual questions it has no value as precedent and its inclusion in the published law reports would serve no public purpose. It therefore directs the clerk that this opinion not be submitted for such publication.